Sanitized Copy Approved for Release 2011/01/18 : CIA-RDP85T00875R00170003

CIT/OER/IM 72-83 Doc/SER

Confidential

DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

Southern Africa's Improved Customs Union

Confidential

ER IM 72-83
May 1972

Copy No. 61

M.204

Sanitized Copy Approved for Release 2011/01/18 : CIA-RDP85T00875R001700030083-6

WARNING

This document contains information affecting the national defense of the United States, within the meaning of Title 18, sections 793 and 794, of the US Code, as amended. Its transmission or revelation of its contents to or receipt by an unauthorized person is prohibited by law.

GROUP 1
Excluded from automatic downgrading and declassification

Sanitized Copy Approved for Release 2011/01/18 : CIA-RDP85T00875R001700030083-6

CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
May 1972

INTELLIGENCE MEMORANDUM

SOUTHERN AFRICA'S IMPROVED CUSTOMS UNION

Introduction

1. The South African - dominated Southern African Customs Union was revised in 1969 to rectify inequities to the three smaller members – Botswana, Lesotho, and Swaziland. Under South African administration, the Union's terms, which have been in effect since 1910, enforced an inequitable distribution of the common customs revenues and raised barriers against the exports of the small states to South Africa. Thus the small members were denied a fair share of one of their few possible revenue sources as well as free access to the South African market, by far the largest in the area. The smaller members' customs revenues have risen sharply since the revision, but South Africa retains control of the Union and is still able to restrict access to the South African market. This memorandum reviews the Union's operation and assesses the implications of the revision for the member countries.

Discussion

Background

2. South Africa completely overshadows the other members of the Southern African Customs Union. Together with South-West Africa, it accounts for nearly 99% of the Union's gross domestic product (GDP) (see Table 1) and about 97% of total imports. South African ports handle most of the smaller states' imports, and South Africa's currency serves as legal tender in all of the member states. Moreover, South Africans own a

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

Table 1

Southern African Customs Union: Comparative Statistics in 1970

	Area (Thousand Square Miles)	Population (Million Persons)	Gross Domestic Product Million US $	Gross Domestic Product US $ per Capita
Total	**1,027**	**24.1**	**18,240**	**760**
South Africa and South-West Africa	788	22.0	18,000 a/	820
Botswana	220	0.7	60	90
Lesotho	12	0.9	100	110
Swaziland	7	0.5	80	160

a. South-West Africa's GDP is estimated.

significant portion of the firms in the three smaller countries and occupy many high-level positions in their industries and governments. Although mining and commercial farming are increasing in importance in the small states, their economies depend mainly on subsistance farming, animal husbandry, and returns from the labor they supply to South African mines and farms. Migratory workers and their dependents total almost 500,000 persons, or about one-quarter of the population of these small countries.

3. The dependence of the three small states on their giant neighbor and South Africa's tendency to dominate them detracts considerably from their freedom, but there are some gains from this close association. The small states benefit from the proximity of the source of supply of some 94% of their imports and from the investment, services, and management that South Africans provide. South Africa's benefits are relatively very minor. One gain is the small but steady net inflow of foreign exchange from the small states' favorable trade balance with countries outside the Customs Union. In 1969, for example, the small states earned some $52 million in foreign exchange while suffering a negative balance with South Africa of $94 million (see Table 2).

4. At the time of the formation of the Southern African Customs Union in 1910, the Union of South Africa (Republic of South Africa), Bechuanaland (Botswana), Basutoland (Lesotho), and Swaziland were colonies of Great Britain (see Figure 1). South-West Africa, mandated in 1920 to South Africa by the League of Nations, was a colony of Germany

Table 2

Botswana, Lesotho, and Swaziland: Trade Balances in 1969 [a]

Million US $

	Total Trade of Small States	Botswana [b]	Lesotho [b]	Swaziland
Imports	129.0 [c]	43.2	33.5	52.3
From South Africa	121.4	40.5	31.8	49.1
From the rest of the world	7.6	2.7	1.7	3.2
Exports	86.3 [c]	18.3	5.7	62.3
To South Africa	26.9	12.0	5.2	9.7
To the rest of the world	59.3	6.3	0.5	52.6
Net trade	-42.7	- 24.9	-27.8	10.0
With South Africa	- 94.5	- 28.5	-26.6	- 39.4
With the rest of the world	51.8	3.6	-1.2	49.4

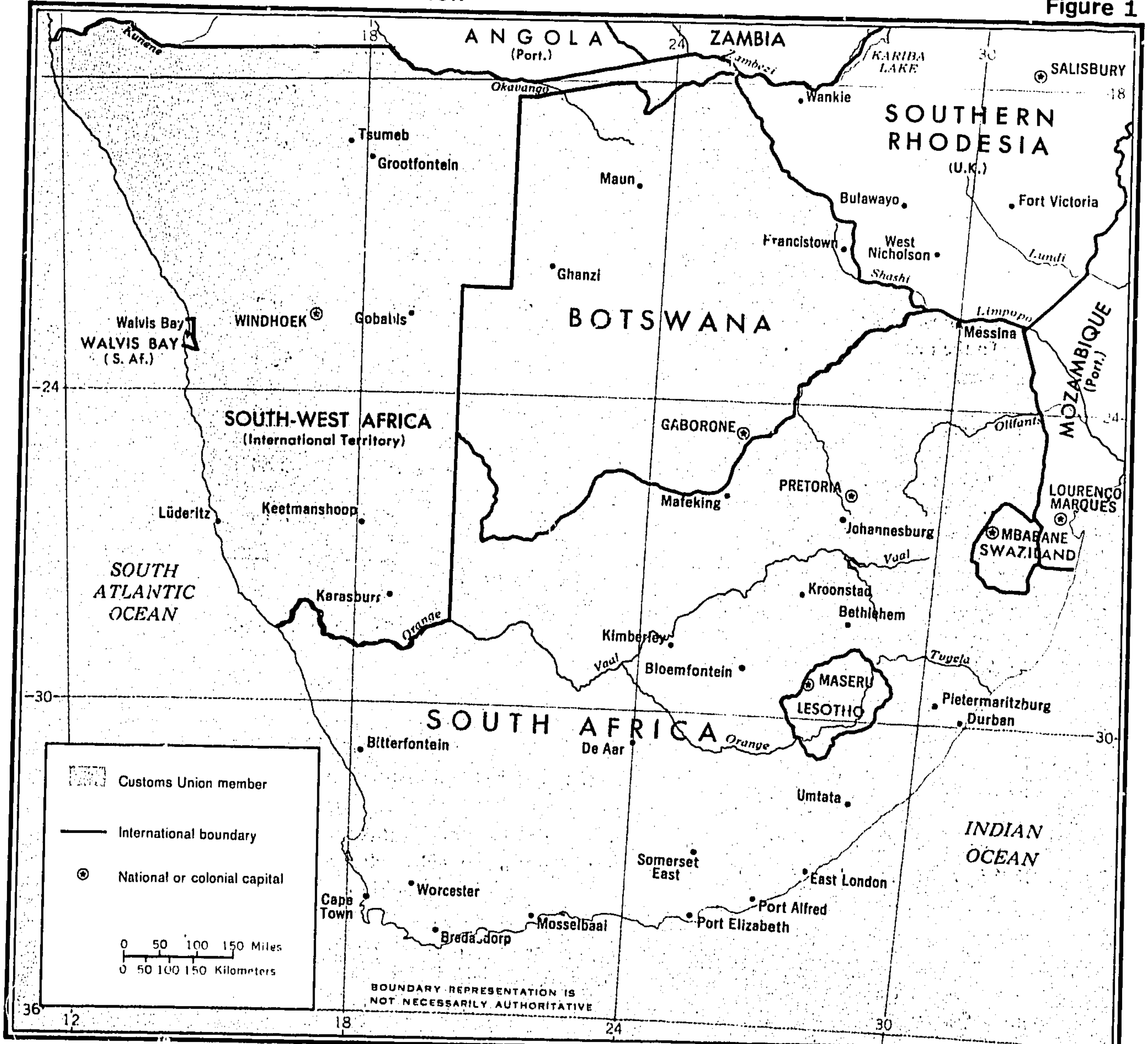
a. Because of rounding, components may not add to the totals shown.
b. Botswana's and Lesotho's trade with South Africa are estimated.
c. In comparison with these data, South Africa's total imports in 1969 were $3,007 million and total exports were $3,266 million.

and has never been officially part of the Union. The highest authority in South Africa, representing the British Crown, was the Governor-General who also served as High Commissioner of the three small territories. The economies of the Customs Union members were tied closely to Great Britain, which supplied most of their imports and purchased the majority of their exports.

5. The United Kingdom, as well as its Southern African colonies, believed that the three smaller countries eventually would be absorbed fully into South Africa. The Parliamentary Act that created the Union of South Africa in May 1910 included provisions for the anticipated incorporation, and the Customs Union, initiated in June of that year, was considered a first step. Although assimilation remained an important element of South African policy through the 1950s, it was blocked by the small states' resistance and the United Kingdom's insistence that their incorporation be voluntary.

Southern African Customs Union

Figure 1



513697 5-72

Growing Inequities of the 1910 Union

6. The principal terms of the 1910 Customs Union were the uniform application of tariffs to external trade, a formula for distributing customs earnings,* and the free exchange of goods among the members. South Africa unilaterally administered the common tariffs, a practice consistant with the expectation that the small states would become South African provinces.

7. Through the first ten to 15 years of operation, Union membership produced net benefits to the smaller members, largely because South Africa bore all administrative costs. This service was a significant saving to the small states. Beginning in the 1920s, however, the common interests of the members began to diverge as the South African economy developed. South Africa's use of the common tariffs, to help stimulate its own growth, made imports more costly for the smaller states. Later, their growing trade deficits with South Africa and lack of control over imports from South Africa increased the cost of Union membership. These disadvantages were compounded, particularly in the 1960s, by the failure of the Union's revenue distribution formula to return fully their share of contributions to the common revenue and by South African self-serving restrictions on intra-Union trade.

8. The small states' combined customs revenues, in FY 1969 (April 1968 - March 1969), amounted to only about 35% of what they presumably would have received were they not members of the Union. About half the loss was due to their inability, because of the Union's common market, to levy tariffs on imports from South Africa. Customs revenues forgone on these imports substantially exceeded the small states' benefits from duty-free exports to South Africa because all three states suffered large trade deficits with South Africa. The remaining half of the loss of customs revenues was due to a growing inequity in the distribution of the common earnings as the small states' imports from outside the common market rose rapidly to meet development needs in the 1960s. The 1910 formula allocated only 1.31% of the Union's revenues for division among the small states, but by 1969 their share of imports (including South African re-exports) had risen to as much as 3%. (For imports and exports by the small states, see Table 3.)

9. By liberal interpretation of the terms of the 1910 Customs Union agreement, South Africa levied intra-Union quotas on some products while denying the same right to the smaller countries. Although such quotas were not used widely and were only one of many factors tending to inhibit investment in the smaller countries, the threat that they represented was

* The formula also was used to distribute the proceeds from excise and sales taxes.

Table 3

Botswana, Lesotho, and Swaziland: Imports and Exports

Million US $

	1951	1961	1965	1969	1970
Total by small states					
Imports	N.A.	31.3	84.6	129.0	N.A.
Exports	N.A.	30.7	64.0	86.3	N.A.
Botswana					
Imports	4.9	8.1	23.2	43.2	N.A.
Exports	6.0	8.8	14.3	18.3	N.A.
Lesotho					
Imports	7.9	8.6	24.3	33.5	32.1
Exports	7.8	4.2	6.6	5.7	5.2
Swaziland					
Imports	N.A.	14.6	37.1	52.3	59.8
Exports	N.A.	17.7	43.1	62.3	70.3

an effective impediment to the establishment, in the small states, of industries large enough to compete throughout the Union.

The 1969 Revision

10. The goal of the negotiations that produced the 1969 revision was to accommodate in the Union's operation the changes since 1910 in the members' economic relationships. In addition to an equitable distribution of the common revenues and unrestricted access to the South African market, the small states sought the advantages that they presumably could achieve by leaving the Union – customs revenues on imports from South Africa and the use of tariffs to help stimulate their industrial growth. Although Pretoria recognized the need for a fair revenue division, it hoped to maintain control of the Union to forestall potential market penetration

by small state industries at the expense of South African businesses. Four major substantive changes resulted: (1) a new formula was constituted for distributing the common revenues, (2) injunctions were made against intra-Union quotas, and the small states were granted (3) consultative roles in operating the Union and (4) special tariff-related investment incentives. In addition, the Union's preamble was expanded to include, as a new goal, the encouragement of the smaller members' development.

11. The new revenue distribution formula reimbursed each member for its annual contribution to the common revenues and provided a 42% increase in each small state's annual share to compensate it for lost earnings due to inability to levy intra-Union tariffs. he amount due each of the small states in any fiscal year is based on the annual receipts of two years earlier, thus providing firm figures for budgeting. (For a detailed description of the formula, see the Appendix.)

12. Although South Africa retains decisive authority, the new consultative provisions give the small states their first direct influence on Union decision-making. The agreement established a permanent Customs Union Commission through which the members can review tariff rates and consider other problems. This arrangement, however, allows South Africa broad areas in which it need not consult and full authority to resolve disputes unilaterally. The provisions state that Pretoria need not consult before initiating "interim measures ... pending the completion of an investigation by the appropriate South African authorities," or tariff changes "designed primarily for fiscal purposes." Moreover, no allowance was made for voting in the Commission that would have enabled the small states to override a South African decision.

13. Revised language specifically precluding quantitative restrictions and duties on the exchange of goods produced within the Union would appear to outlaw South Africa's intra-Union quotas, but Pretoria was given an opportunity to justify their continuation. Contradictory language allowing intra-Union quotas for "economic, social, cultural, and other reasons" provides an opportunity for manipulation despite a repeated injunction against the use of quotas for the purpose of protecting a member's own industries. South Africa agreed, however, not to discriminate against the small states in applying the restrictive actions of its agricultural commodity marketing boards, which sell most of the farming produce for all members.

14. South Africa accepted two new provisions to aid the small states' industrial growth. Each small state, after consultation with the other members, can levy temporary tariffs on intra-Union imports that are competitive with its own new industries and can request increases in or

bar the reduction of common tariffs affecting industries that it designates as particularly important to its economy. South Africa agreed to "give sympathetic consideration" to setting low enough common internal excise duties on products of "specified" industries to allow the tariff incentives to work.

Major Implications

15. The revisions significantly improved the advantages of Union membership to the small states. The more equitable distribution of the common revenues and the compensation for their inability to levy tariffs on imports from South Africa more than tripled the smaller members' customs revenues. Applied first in FY 1970, the new revenue distribution formula produced a $15.7 million increase in the small states' combined customs receipts over the amounts anticipated prior to the agreement's signing. Customs receipts rose to 36% of the smaller countries' total current government revenues in FY 1970 and to 48% in FY 1972, compared with 14% in 196[illegible] (see Figure 2). The increase produced a significant rise in Swaziland's total current revenues by FY 1972 but was offset in Botswana and Lesotho by sharp reductions in UK budget aid. Relieved of most of the current budget grants, however, the United Kingdom increased by $15 million its three-year development loan commitments, almost 75% more than the UK developmental aid spent in the small countries during FYs 1968-70. The loss to South Africa amounted to only 0.5% of the country's total government revenues.

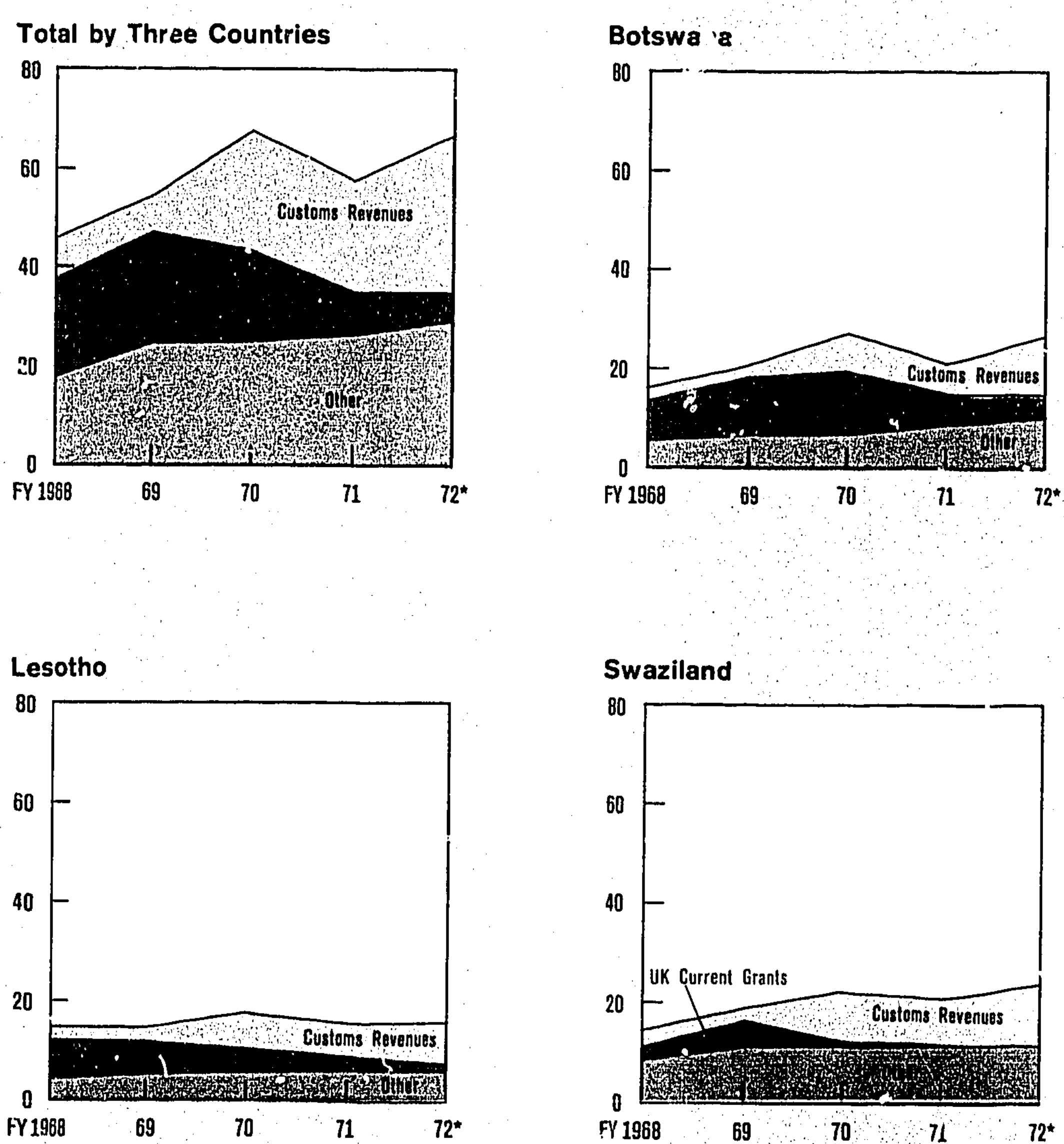
16. The small states' revenues are likely to be less stable because customs receipts depend more than previously on each state's own import levels. In Botswana, for example, the planned completion in 1973 of mining developments will cause a reduction in machinery and equipment imports and a 50% drop in customs revenues if no offsetting adjustments are made. Most such reductions, however, will be easily predictable in view of the distribution formula's provision for a two-year delay before allocating each year's receipts.

17. Probably the most important issue facing the small states is unfettered access to the South African market. To achieve meaningful growth and diversification, the small states must be able to sell their products in South Africa. South African businesses fear this competition because of the advantage the small states possess in their relative abundance of cheap labor. Since most industries would depend on imports for raw materials, Pretoria can use its authority in the Union to manipulate tariffs and nullify any competitive advantage, thus discouraging the establishment of competing industries.

Figure 2

Botswana, Lesotho, and Swaziland: Current Revenues

Million US $



*Budgeted

513698 5-72

18. Currently under negotiation, for example, are proposed increases in Union tariffs on ammonia and phosphoric acid imports. The increases are promoted by South African fertilizer manufacturers in an attempt to forestall the building of a factory in Swaziland which, using raw materials from Iran, would produce enough to fulfill about one-third of South Africa's fertilizer needs at reduced prices. Whenever threatened, South African industry will undoubtedly bring pressure on Pretoria to use its control over the Union to protect domestic interests.

19. Without unrestricted access to the common market, the small states' benefits from the two new tariff-related investment incentives probably will be small. South African resistance to market encroachment will tend to negate the promise of tariff protection from external competition, which was the purpose of the provision giving the small states an influence on common tariffs. The second incentive – the provision for temporary intra-Union tariffs – will protect new industries within each country, but because of the narrowness of the small states' domestic markets, benefits will be very small.

20. Despite the predictable outcome of conflicts concerning the small states' common market access, Pretoria's intention probably is to conduct meaningful consultations on most Union issues. There is no doubt that the Customs Union Commission represents a gain to the small states over the former complete lack of a facility to negotiate Union-related issues. It is in Pretoria's interest, moreover, to maintain harmonious relations with the small states, which are South Africa's nearest Black-governed neighbors, in view of the proclaimed South African policy of improving contacts with other sub-Saharan countries.

Conclusions

21. South Africa probably assesses the Customs Union revision in 1969 as a political gain. Pretoria's retention of decisive authority over the common tariffs, at a very small cost in revenues, has increased its economic influence over the smaller countries' since the latter's reliance on the Union for current revenues has greatly increased. Its willingness to negotiate new terms more favorable to the Black independent states is also in its favor in the eyes of the rest of the continent.

22. The revised Union, however, goes only a little way toward meeting its proclaimed goal of encouraging the development and diversification of the smaller members' economies. The provisions for tariff-related investment incentives probably will not stimulate investment greatly. They have not

been used in the more than two years since the revision was signed. Moreover, almost no progress has been made in opening the South African market to new products from the smaller states, an absolute necessity if the small states are to develop significantly. The Customs Union Commission, made up of all member states, has no real authority, and the Union remains subject to South African policy. An increase in the Commission's authority is unlikely. The South African stake is too great and private business interests are too powerful to expect that the small states will ever be allowed to play a major role in the Union.

23. The 1969 revision, nevertheless, improves the financial returns of Union membership to Botswana, Lesotho, and Swaziland. The smaller members now receive customs revenues that approximate those that they could collect as non-members. Although withdrawal from the Union would increase the smaller countries' flexibility in manipulating tariffs, it probably would lessen their chances even more to increase exports to South Africa. As non-members, the small states would be subject to South Africa's import tariffs, whereas within the Union there is some hope that their exports to South Africa may be increased gradually.

APPENDIX

Distribution of the Southern African Customs Union Proceeds to Botswana, Lesotho, and Swaziland

Before the 1969 revision, the smaller members annually divided an amount equal to 1.31% of the Union's proceeds. The division of this percentage share among the three smaller members was changed by the United Kingdom in 1965 to reflect changes in the relative levels of their imports, as shown in the following tabulation:

	Percent of Union Revenues	
	1910-64	1965-68
Total	**1.31097**	**1.31097**
Botswana	0.27622	0.30971
Lesotho	0.88575	0.47093
Swaziland	0.14900	0.53033

The revision in 1969 re-allocated the revenues to reflect, as nearly as possible, each smaller member's actual contribution to the Union, and to compensate each small state for its inability to levy tariffs on imports from South Africa. Excise and sales taxes, which contribute about 53% of the Union's revenue pool, also were incorporated in the new allocation. The members negotiated a four-step formula which, based on the receipts of two years earlier, allocated the revenues by (1) calculating each small state's total imports as a percentage of the sum of the Union's imports and tariff proceeds, (2) adding the result to the percentage of the Union's sales and excise taxes contributed by that state, (3) multiplying the sum by the value of the Union's total revenue pool, and (4) increasing the result by 42%. Algebraically, the formula can be expressed as follows:

$$\text{Any small state's share} = \left(\frac{A}{B + C} + \frac{D + E}{F + G}\right) \cdot P \cdot 1.42$$

Where: A = value of the small state's imports,

B = value of the Union's imports,

C = tariff proceeds on the Union's imports,

D = value of the small state's production and consumption of goods subject to excise and sales taxes

E = excise and sales tax revenues earned on "D,"

F = value of the Union's production and consumption of goods subject to excise and sales taxes,

G = excise and sales tax revenues earned on "F,"

P = value of the Union's revenue pool, and

1.42 = compensatory increase

Although available data are inconclusive, it appears from import and revenue statistics in FY 1970 that the revenue allocation to the small states is very close to being equitable. In FY 1970 the small states were allocated 4.1% of the revenue pool and their combined imports amounted to approximately 4.3% of the Union's imports. The apparent deficiency in the percentage allocated from the pool in that year, however, probably can be explained by the small states' proportionately low imports of consumer goods, which are subject to the highest tariff, excise, and sales taxes, and by the inadequacy of statistics in FY 1968, the base year used to calculate the FY 1970 allocation. The small states have initiated programs to improve their collection of statistics which will facilitate revenue allocations in the future.